

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF ATMOS ENERGY CORPORATION)	CASE NO.
FOR AN ADJUSTMENT OF RATES AND TARIFF)	2013-00148
MODIFICATIONS)	

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ORDER

Atmos Energy Corporation (“Atmos”), a gas distribution company operating in eight states, serves roughly 3.1 million customers. Its Kentucky/Mid-States division, one of six operating divisions, provides natural gas service in Kentucky, Tennessee and Virginia. Atmos’s Kentucky unit (“Atmos-Ky.”) serves approximately 173,000 customers in 38 central and western counties in Kentucky. The most recent adjustment of its Kentucky operating unit’s base rates was in May 2010 in Case No. 2009-00354.¹

BACKGROUND

On May 13, 2013, Atmos-Ky. submitted its application based on a forecasted test period ending November 30, 2014, seeking an increase in revenues of \$13,367,575, or 8.6 percent, with a proposed effective date of June 13, 2013.

A review of the application revealed that it did not meet the minimum filing requirements of 807 KAR 5:001, Sections 4 and 16, and a notice of filing deficiencies was issued. Atmos-Ky. filed information on May 30, 2013, and June 3, 2013, to cure

¹ Case No. 2009-00354, *Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC May 28, 2010).

the noted filing deficiencies. Our June 24, 2013 Order found that this information satisfied all of the filing requirements cited in our deficiency notice except the requirement for Atmos-Ky. to post its application and other documents on its website. The Commission found that this deficiency would remain until Atmos-Ky. provided proof that it had posted its application and other documents filed with its application on its website. Atmos-Ky. responded to that Order that same day by providing a copy of the page that had been posted on its website listing the documents. A notice that Atmos-Ky.'s deficiencies had been cured was issued June 26, 2013, stating that that the application met the minimum filing requirements as of June 24, 2013. Based on a June 24, 2013 filing date, the earliest possible date Atmos-Ky.'s proposed rates could become effective was July 24, 2013.

The Commission found that an investigation would be necessary to determine the reasonableness of Atmos-Ky.'s proposed rates and suspended them for six months, from July 24, 2013, up to and including January 23, 2014, pursuant to KRS 278.190(2). The suspension Order included a procedural schedule which provided for discovery on the application, intervenor testimony, discovery on any intervenor testimony, rebuttal testimony by Atmos-Ky., a public hearing, and an opportunity to file post-hearing briefs.

Petitions to intervene were filed by the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), Kentucky Industrial Utility Customers, Inc. ("KIUC"), and Stand Energy Corporation ("Stand").² The AG was granted full intervention and Stand was granted full intervention, limited to participation on the issues of Atmos-Ky.'s transportation threshold levels and any matters related

² KIUC later withdrew its petition to intervene.

thereto. Discovery was conducted on Atmos-Ky.'s application by both the AG and the Commission Staff ("Staff"). The AG filed testimony on which discovery was conducted by both Atmos-Ky. and Staff. Atmos-Ky. filed rebuttal testimony and the AG filed supplemental testimony in response to which Atmos-Ky. filed surrebuttal testimony. Stand filed no testimony.

Pursuant to KRS 278.190(2), Atmos-Ky. gave notice on January 22, 2014, of its intent to place its proposed rates in effect for service rendered on and after January 24, 2014. In our January 28, 2014 Order, we acknowledged that Atmos-Ky. had complied with the statutory provisions for placing its proposed rates in effect. That Order required that Atmos-Ky. maintain its records so that, in the event a refund were to be required, the amount of refunds and the customers to whom the refunds should be applied could be determined.

The Commission held an evidentiary hearing on the proposed rate adjustment on December 3, 2013 and January 23, 2014, at its offices in Frankfort, Kentucky. Post-hearing briefs were filed by Atmos-Ky., the AG, and Stand. All information requested at the formal hearing has been filed and the case now stands submitted for a decision. As discussed more thoroughly throughout this Order, the Commission is granting Atmos-Ky. a base-rate increase of \$8,550,134, which is roughly 64 percent of what it requested and which represents an increase in total revenues of approximately 5.5 percent.

TEST PERIOD

Atmos-Ky. proposed the 12 months ending November 30, 2014, as its forecasted test period to determine the reasonableness of its proposed rates. While the AG did not object to the proposed test period or suggest an alternative test period, he criticized

Atmos-Ky.'s development of certain items contained in its proposed test period. The AG raised concerns with Atmos-Ky.'s forecasted filing regarding its lack of documentation, methodology, and specific impacts on costs.³ The AG stated that he did not agree with using a forecasted test period, but that Atmos-Ky. did not respond adequately to certain data requests he propounded to elicit information that would have permitted a more thorough review of the data supporting the forecasted test period.⁴

Atmos-Ky. stated that its development of a forecasted test period begins with its budget, which it prepares annually for its October 1 to September 30 fiscal year. It described the numerous approvals to which its budgets are subjected, including the final review by the Atmos Board of Directors. Atmos-Ky. noted that, along with its Kentucky operations, Atmos maintains a Division General Office ("DGO") that manages utility operations in the states, including Kentucky, which make up the Kentucky/Mid-States division. It further noted that Atmos has a Shared Services Unit ("SSU") which provides support services such as accounting, billing, tax, call center, collections, etc., to the various operating divisions. Atmos-Ky. stated that separate budgets are developed each year at the Kentucky, DGO, and SSU levels.

The Commission finds Atmos-Ky.'s forecasted test period to be reasonable and consistent with the provisions of KRS 278.192 and Kentucky Administrative Regulation

³ Direct Testimony of Bion C. Ostrander ("Ostrander Testimony") at 6.

⁴ *Id.* at 7, 13, and 14.

5:001, Section 16 (6), (7), and (8). Therefore, we will accept the forecasted test period as proposed by Atmos-Ky. for use in this proceeding.⁵

VALUATION

Rate Base

Atmos-Ky. proposed a net investment rate base for its forecasted test period of \$252,914,292 based on the 13-month average for that period.

The AG proposed to reduce Atmos-Ky.'s rate base to eliminate Net Operating Loss Carry-forwards ("NOLC") resulting from the losses reported by Atmos's regulated operations for tax purposes.⁶ The AG stated that while he had no concerns with typical accumulated deferred income taxes ("ADIT") used to reduce rate base, an NOLC debit is an offset to the typical credit balance in ADIT, causing an increase in rate base.⁷

The AG opined that removing the NOLC from rate base would not cause a tax normalization violation.⁸ In support of his recommendation, the AG cited a recent case before the West Virginia Commission in which Mountaineer Gas's proposal to include a NOLC in its rate base was denied.⁹ If there was substantive disagreement by Atmos-

⁵ Contrary to his contentions, we find that the AG had adequate opportunity to conduct discovery for the purpose of analyzing the proposed test period and components thereof. The Commission notes that the use of a forecasted test period is provided for in 807 KAR 5:001, Section 16. We also note that the criticism by AG witness Ostrander to the use of a forecasted test period, as he has done in this case and the two recent rate cases of Big Rivers Electric Corporation, is not supported by law or regulation. The AG did not file any motions regarding discovery disputes until his motion on Nov. 21, 2013 requesting that the Dec. 3, 2013 Hearing be postponed, which the Commissioner granted.

⁶ The amount the AG removed from rate base was \$22,221,329, which was an estimate. Atmos-Ky. clarified that that the NOLC amount included in its rate base was \$20,125,550.

⁷ Ostrander Testimony at 49.

⁸ *Id.* at 51.

⁹ *Id.* at 55.

Ky. on the NOLC rate base issue, the AG recommended that Atmos-Ky. obtain a private-letter ruling from the Internal Revenue Service (“IRS”) to resolve the issue.¹⁰

Atmos-Ky. claimed that removing the NOLC from rate base would result in a tax normalization violation of the Internal Revenue Code.¹¹ It stated that a violation would cause it to lose accelerated depreciation, bonus depreciation, and other tax benefits. Atmos-Ky. also claimed that removing NOLCs from its rate base is inappropriate and inconsistent with sound ratemaking principles, and that inclusion of NOLCs in rate base has been accepted by many commissions, including these in all other states in which Atmos’s distribution companies operate.¹² It noted that the Mountaineer Gas case cited by the AG is the only instance in which a utility regulator ruled that NOLC should not be included in rate base.¹³ Atmos-Ky. stated that if the Commission determined that its NOLC should remain in rate base, there was no need to involve the IRS with a private letter ruling request. However, if the Commission requires that it seek such a ruling, Atmos-Ky. asks to be allowed to create a regulatory asset to defer the costs related to such a request and seek recovery of them in its next general rate case.¹⁴

The Commission is not persuaded by the AG’s argument. While there is some ambiguity in the Treasury regulations cited by the AG and Atmos-Ky. on the subject of NOLCs, we are unable to agree with the AG that a tax normalization violation would not

¹⁰ *Id.* at 57-58.

¹¹ Rebuttal Testimony of Pace McDonald at 4.

¹² *Id.* at 16-19 and 22.

¹³ *Id.* at 21.

¹⁴ Atmos-Ky.’s post-hearing brief at 17.

result from a decision to remove NOLCs from Atmos-Ky.'s rate base. The AG has not made a compelling argument for why, from a ratemaking perspective, it would be reasonable to adopt his recommendation.

Although we are rejecting the AG's proposal, the aforementioned ambiguity in the governing regulations and the significantly different interpretations of those regulations by the AG and Atmos-Ky. cause the Commission to conclude that it would be beneficial to have a more definitive assessment of this issue.¹⁵ Therefore, we find that Atmos-Ky. should seek a private-letter ruling from the IRS with the intent that such ruling be filed with the application in Atmos-Ky.'s next general rate case. We also find that Atmos-Ky. should be permitted to create a regulatory asset to defer the costs related to its private-ruling request in order to seek their recovery in its next general rate case.

Having rejected the AG's proposal to exclude the NOLC, the Commission has determined that Atmos's net investment rate base is \$252,737,721 as shown below. Cash working capital has been reduced to reflect the adjustments to operation and maintenance ("O&M") expenses discussed later in this Order.

Utility Plant in Service	\$ 445,835,433
Construction Work In Progress	<u>8,541,792</u>
Total Utility Plant	\$ 454,377,225
LESS:	
Accumulated Depreciation	<u>\$ 166,889,761</u>
Net Utility Plant	\$ 287,487,464
ADD:	
Gas Stored Underground	\$ 9,415,216
Materials and Supplies	58,851
Prepayments	1,254,362
Working Capital	<u>3,160,640</u>

¹⁵ It is possible that the NOLC issue may be at issue in future Atmos-Ky. rate cases.

Subtotal	\$ 13,889,069
DEDUCT:	
Customers Advances for Construction	\$ 2,745,576
Accumulated Deferred Income Taxes And Investment Tax Credits	<u>45,893,236</u>
Subtotal	\$ 48,638,812
NET INVESTMENT RATE BASE	<u>\$ 252,737,721</u>

CAPITAL STRUCTURE

As a division of Atmos, Atmos-Ky. does not have a stand-alone capital structure. Using Atmos's capital balances, Atmos-Ky. proposed a test-period capital structure consisting of 51.83 percent common equity and 48.17 percent long-term debt. It also presented a second capital structure for informational purposes consisting of 49.16 percent common equity, 45.68 percent long-term debt, and 5.16 percent short-term debt.¹⁶ Atmos-Ky. stated that the capital structure containing no short-term debt was appropriate for determining its revenue requirement in that Atmos-Ky. did not use short-term debt to finance the long-lived assets in its rate base.¹⁷

The Commission is not persuaded by Atmos-Ky.'s reasoning for not reflecting short-term debt in its capital structure. To the extent there is a connection between long-lived assets and long-term forms of capital, the Commission has recognized that a utility's rate base includes items other than long-lived plant assets that may be financed

¹⁶ The second capital structure reflected a short-term debt component based on the average short-term debt balance of Atmos for the 12 months ended March 31, 2013.

¹⁷ Cross-examination of Gregory K. Waller, January 23, 2014 Hearing at 16:55:50 – 16:56:04.

with short-term debt.¹⁸ Furthermore, while it is the intent of utilities, from a planning perspective, to finance long-lived assets with long-term forms of capital, from a practical perspective the Commission has long held the position that capital cannot be assigned directly to a particular state, jurisdiction or specific asset.¹⁹

In its last litigated case, Atmos-Ky., formerly Western Kentucky Gas, (“Western”), proposed a capital structure that contained no short-term debt. However, finding that “Western uses significant amounts of short-term debt on an ongoing basis...” the Commission approved a capital structure containing 8.47 percent short-term debt.²⁰ In the time since that case, the Commission has issued decisions in 14 litigated rate cases involving investor-owned gas or electric utilities, or combination gas and electric utilities. In 13 of those cases, the Commission authorized a capital structure containing a short-term debt component. The one exception occurred when the utility had used its short-term debt to reacquire bonds during the historical test period used in that case.²¹

Having considered Atmos-Ky.’s argument and the historical practice employed in Kentucky rate cases for more than two decades, we find that the appropriate capital structure in this matter should include a short-term debt component. Accordingly, based on the record evidence, the Commission will approve for ratemaking purposes a capital

¹⁸ Case No. 8738, *An Adjustment of Rates of Columbia Gas of Kentucky* (Ky. PSC July 5, 1983) at 21.

¹⁹ Case No. 9678, *An Adjustment of Rates of General Telephone Company of the South* (Ky. PSC Apr. 16, 1987) at 9. Case No. 10117, *Adjustment of Rates of GTE South, Inc.* (Ky. PSC Sept. 1, 1988) at 11.

²⁰ Case No. 90-013, *Rate Adjustment of Western Kentucky Gas Company* (Ky. PSC Sept. 13, 1990) at 19.

²¹ Case No. 2009-00549, *Application of Louisville Gas and Electric Company for an Adjustment of Electric and Gas Base Rates* (Ky. PSC July 30, 2010).

structure that contains 49.16 percent common equity, 45.68 percent long-term debt, and 5.16 percent short-term debt.

REVENUES AND EXPENSES

Atmos-Ky. developed an operating statement for its forecasted test period based on its budgets for fiscal years 2013 and 2014. As required by 807 KAR 5:001, Section 16(6)(a), the financial data for the forecasted test period was presented by Atmos-Ky. in the form of pro forma adjustments to its base period, the 12 months ending July 31, 2013.²² Based on the assumptions built into its budgets, Atmos-Ky. calculated its test-year operating revenues and Operations and Maintenance (“O&M”) expenses to be \$155,374,969 and \$141,914,890, respectively.²³ These test-year operating revenues included gas cost revenues of \$90,265,243, based on Atmos-Ky.’s estimate of gas cost to be recovered through its Gas Cost Adjustment mechanism.²⁴

Based on the adjusted revenues and O&M expenses stated above, Atmos-Ky.’s test-period operating income was \$13,460,079, which, based on its proposed rate base, results in a 5.32 percent overall rate of return. Based on a proposed return on equity (“ROE”) of 10.7 percent, Atmos-Ky. determined that it required a revenue increase of \$13,367,575, which would produce an overall return on rate base of 8.53 percent.

The AG, based on a number of proposed adjustments to Atmos-Ky.’s test-period results, and a 7.63 percent overall return on rate base, calculated Atmos-Ky.’s operating

²² Application, Vol. 9 of 9, Schedules D.1 and D.2.

²³ *Id.* Schedule C-1.

²⁴ In response to Item 28 of Staff’s Second Request for Information (Staff’s Second Request”), Atmos-Ky. updated its estimate of gas cost revenues for the test period to \$111,008,901.

revenue to be \$16,831,319 and recommended an increase in revenues of \$1,215,895.²⁵ The AG later revised his recommendation, and increased the amount of the revenue increase to \$2,736,433.²⁶

The Commission will accept most components of Atmos-Ky.'s test period and many of its proposed adjustments. We will also accept some of the AG's proposed adjustments. A discussion of the individual adjustments accepted, modified or rejected by the Commission and the impact of those adjustments on Atmos-Ky.'s revenue requirement follows.²⁷

Revenue Normalization

In normalizing test period revenues, Atmos-Ky. increased its firm sales volumes by 2,189,876 Mcf to reflect its adjustment for weather normalization based on the National Oceanic and Atmospheric Administration's ("NOAA") normal Heating Degree Day ("HDD") data for the 30-year period ending 2010.²⁸ It further adjusted its firm sales volumes by (427,287) Mcf to reflect changes in consumption due to a long-standing trend in conservation and efficiency by its residential, commercial, and public authority customer classes. For other classes, Atmos-Ky. adjusted customer numbers and sales and transportation volumes for known and measurable changes in service contracts and

²⁵ Ostrander Testimony, Exhibit BCO-2, Schedule A-1.

²⁶ Supplemental and Corrected Direct Testimony of Bion C. Ostrander ("Ostrander Corrected Testimony") at 2.

²⁷ Two AG adjustments to which Atmos-Ky. agreed on rebuttal were: a reduction in bad-debt expense of \$25,048 and removal of duplicate billing systems' maintenance fees in the amount of \$51,262.

²⁸ Direct Testimony of Mark A. Martin ("Martin Testimony"), Exhibit MAM-4.

customer usage, resulting in a decrease in interruptible sales volumes of approximately 330,000 Mcf and an increase in transportation volumes of approximately 500,000 Mcf.²⁹

The Commission finds Atmos-Ky.'s adjustments to be reasonable and accepts its normalized base-rate revenues. With regard to weather normalization methodology to be used in future rate proceedings, the Commission finds that Atmos-Ky. should use the most recent temperature data available. In response to a Staff request for information, Atmos-Ky. stated its belief that there is a benefit to using NOAA's published 30-year temperature normal product, because NOAA thoroughly analyzes the data and smooths the average daily HDD to produce daily normals.³⁰ Because the Commission is aware that this is the case, and with the data's having been published in July 2011, it is reasonable to use the 30 years ended 2010 to weather normalize sales volumes and revenues in this case. The Commission does not believe it would be reasonable to continue to use the same 30-year period to weather normalize sales volumes and revenues in future rate proceedings brought prior to NOAA's next published 30-year temperature-normal product, and therefore, we will require that a more current time period be used. The Commission will also require that Atmos-Ky. file a comparison of weather normalization methodologies using time periods including, but not limited to, 20, 25, and 30 years in length. Along with its comparison of results, Atmos-Ky. should include support for the time period it proposes to use to normalize revenues, including the superiority of the chosen method in terms of its predictive value for future temperatures.

²⁹ *Id.*, Exhibit MAM-3.

³⁰ Response to Staff's Second Request, Item 26.

Payroll and Benefits

Atmos-Ky.'s test period includes combined direct payroll and benefits expense of \$8,865,683. It also includes allocated DGO and SSU payroll and benefits expenses of \$7,570,803. The AG compared these amounts to the actual fiscal year 2012 payroll and benefits expenses incurred by Atmos-Ky. and the amounts allocated to it by DGO and SSU for that period and recommended an adjustment to reduce test-period payroll and benefits expenses by one-half of the difference, or \$1,212,712.³¹ The AG claimed that the levels proposed by Atmos-Ky. represented significant and unusual increases for which Atmos-Ky. had failed to meet a reasonable burden of proof.³²

Atmos-Ky. asserted that the AG's adjustment ignores the guidelines set forth in 807 KAR 5:001, Section 16(6)(a), which require that test-period adjustments are to be made to the base period. It also asserted that the AG's adjustment is founded on an arbitrary and unsupported 50 percent reduction factor.³³ Atmos-Ky. explained that the sale of Atmos's Missouri, Illinois, Iowa, and Georgia operations, all of which were part of the Kentucky/Mid-States' division, increased its share of allocated costs from both DGO and SSU, which increased its test-year payroll and benefits expense levels.³⁴ It stated that the payroll and benefits amounts included in its forecasted test year are consistent

³¹ Ostrander Corrected Testimony at 37-38.

³² *Id.* at 42.

³³ Surrebuttal Testimony of Joshua C. Densman ("Densman Surrebuttal") at 5-6.

³⁴ Rebuttal Testimony of Jason L. Schneider ("Schneider Rebuttal") at 4.

with the Commission's regulation for forecasted test periods and that said amounts are the most reasonable forecasts of payroll and benefits for the test year.³⁵

The Commission does not accept the AG's recommended adjustment. While the increases in some items between Atmos-Ky.'s fiscal year 2012 and the forecasted test period are notable, it is clear that a major contributing factor was the sale of other Atmos properties, which increased the amounts allocated to Atmos-Ky. The provisions of 807 KAR 5:001, Section 16(6)(a), which dictate how an applicant utility is to present its test year when it uses a forecasted test period, do not govern nor limit an intervenor's analysis of the test year. However, the AG's use of Atmos-Ky.'s 2012 fiscal year as the benchmark to which he compared the test period is not persuasive. Furthermore, although there are instances in which a sharing by ratepayers and shareholders is the basis for reducing a cost by 50 percent for ratemaking purposes, in this instance it does not appear that such a sharing was the intent, but that the AG's use of 50 percent was arbitrary and unsupported, as Atmos-Ky. claimed. For these reasons, we reject the AG's adjustment to reduce Atmos-Ky.'s test year payroll and benefits expense.

Inflation Factor

To forecast "Other O&M" (operating expenses other than (1) labor, (2) benefits, (3) rent, maintenance and utilities, and (4) bad debt) for the test year, Atmos-Ky. applied an inflation factor of 2.7 percent using the approved expense levels in its fiscal year

³⁵ Densman Surrebuttal at 8-9.

2013 as the starting point.³⁶ This inflation factor was the average inflation rate for the Midwest region for the last three years, as reported by the U.S. Department of Labor.³⁷

The AG opposed Atmos-Ky.'s use of an inflation factor to forecast test-period expenses and proposed an adjustment of \$496,907 to remove the impact of inflation. The AG stated that Atmos-Ky. had not met a reasonable burden of proof regarding this item and did not show that there was a proper correlation between its generic inflation factor and the actual historic changes in the expenses to which it applied the inflation factor.³⁸ He argued that use of the Consumer Price Index ("CPI") was inappropriate because the ". . . CPI basket of goods and services is not representative of Atmos' expenses" and that Atmos had not addressed or reconciled this inconsistency.³⁹ The AG noted that his proposed adjustment reflected his belief that Atmos-Ky. had applied the inflation factor to both test-period and base-period expenses.⁴⁰

On rebuttal, Atmos-Ky. stated that it did not apply the inflation factor to its base-period expenses. It described an error in the AG's calculation of the amount to which he applied the percent inflation factor in the test year.⁴¹ After adjusting for these items, the correct impact of Atmos-Ky.'s use of the inflation factor is an expense increase of

³⁶ For insurance expense, Atmos-Ky. applied a 5 percent inflation factor reflect that to recent increases in insurance costs have been greater than increases in the other components of "Other O&M."

³⁷ Direct Testimony of Joshua C. Densman ("Densman Testimony") at 15.

³⁸ Ostrander Corrected Testimony at 12.

³⁹ *Id.* at 13.

⁴⁰ *Id.* at 16 and 22-23.

⁴¹ Densman Rebuttal at 2-5.

\$171,804.⁴² Atmos-Ky. stated that use of an inflation factor for a forecasted test year is appropriate and that its methodology is consistent with what has been used in prior cases.⁴³

While it has on occasion accepted inflation-related adjustments for individual expense items,⁴⁴ the Commission has not been, and is not now, inclined to accept an expense level based on application of a standard, or generic, inflation factor to a mix of approximately a dozen different cost categories ranging from Vehicles and Equipment to Travel and Entertainment. Commission orders in prior cases stated the Commission's view on this type of CPI-based proposal by finding that using the CPI relies "...upon too large and diverse a group of goods and services." In its decision involving the water rates of the city of Lawrenceburg, the Commission also stated that the adjustment proposal "...must provide an accurate measurement of changes in the cost of providing water service. It therefore should be based principally on those goods and services that are reasonably likely to be used to provide water service."⁴⁵ The Commission reasoned that a proper adjustment "...should reflect all changes in the cost of the inputs that are required to provide water service" (emphasis in original) and that

⁴² *Id.* at 5.

⁴³ *Id.*

⁴⁴ Case No. 2012-00520, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Oct. 25, 2013) at 34-35.

⁴⁵ Case No. 2006-00067, *Proposed Adjustment of the Wholesale Water Rate of the City of Lawrenceburg, Kentucky* (Ky. PSC Nov. 21, 2006) at 3-4.

reliance on the CPI would "...not reflect any reductions in the cost of service, only increases."⁴⁶

Finding no persuasive reason to depart from its previous decisions on the reasonableness of basing cost increases on a generic inflation factor, the Commission denies Atmos-Ky.'s proposal.⁴⁷ With the corrections to the AG's adjustment provided in Atmos-Ky.'s rebuttal, the result is a \$171,804 reduction in test-year operating expenses.

DGO and SSU Allocated Expenses

Atmos-Ky. included \$10,876,844 and \$13,071,350 in allocated expenses from DGO and SSU in its base period and test period, respectively. It stated that the budget development procedures used to develop its Kentucky budget are also used to develop the budgets of DGO and SSU.⁴⁸ Atmos-Ky. explained that costs incurred at DGO and SSU are allocated according to the Cost Allocation Manual ("CAM"), which was developed by Atmos at the corporate level and which is applied uniformly for the allocation of common costs in all states in which Atmos has regulated utility operations.⁴⁹

Based on the difference between the allocated expenses in the test year and the actual allocated expense of \$10,086,333 incurred by Atmos-Ky. in its 2012 fiscal year, the AG proposed an adjustment to reduce the test-year amount by \$1,492,500.⁵⁰ Citing

⁴⁶ *Id.*

⁴⁷ To reiterate something brought out in the hearing, while Atmos-Ky.'s proposal is consistent with that used in prior cases, those cases were settled and did not require a Commission decision.

⁴⁸ Densman Testimony at 7.

⁴⁹ Direct Testimony of Jason L. Schneider ("Schneider Testimony") at 14.

⁵⁰ Ostrander Corrected Testimony at 25.

the increases in DGO and SSU allocated expenses from 2012 to the test period, after Atmos-Ky. experienced three consecutive years of decreases in these expenses, the AG characterized the increases as “significant and unusual” and claimed that Atmos-Ky. did not provide adequate explanation and documentation in support of such increases.⁵¹

On rebuttal Atmos-Ky. asserted that the overriding reason for the increases in its share of the expenses allocated from DGO and SSU are changes in the factors used in determining the allocations among Atmos’s divisions and affiliates.⁵² It explained that the principal driver of changes in the allocation factors and its increased levels of DGO and SSU expenses was the 2012 sale of Atmos’s Missouri, Illinois, and Iowa operations and the 2013 sale of Atmos’s Georgia operations.⁵³ Atmos-Ky. stated that the same cost allocation methodology had been applied consistently in accordance with its CAM since the 2001 inception of the CAM.⁵⁴ It also stated that use of that methodology had resulted in decreases in allocated DGO and SSU expenses in the past.⁵⁵

The Commission does not find the AG’s position to be persuasive and will not approve his proposed adjustment. It is unfortunate for its ratepayers that Atmos-Ky.’s share of expenses incurred at the DGO and SSU levels has been increasing; however, it has adequately explained that the sale of Atmos’s operations in other states, all of which were in the Kentucky/Mid-States division, caused the increases. Furthermore, it

⁵¹ *Id.* at 30-32.

⁵² Schneider Rebuttal at 6.

⁵³ *Id.* at 5-6.

⁵⁴ Schneider Testimony at 14.

⁵⁵ Schneider Rebuttal at 5.

has provided the revised allocation factors on which its current allocation is based, and these support its stated position. Accordingly, the AG's proposed adjustment is denied.

Employee Incentive Pay

Atmos-Ky. included \$1,164,455 in employee incentive pay in its forecasted test-period operating expenses. The incentive pay reflects the following three plans under which different groups of employees are compensated: (1) Long-Term Incentive Plan; (2) Management Incentive Plan; and (3) Variable Pay Plan.⁵⁶

The AG recommended an adjustment that would eliminate half, or \$582,228, of the incentive pay expense from rate recovery.⁵⁷ As support for his recommendation, the AG noted that all three plans awarded incentives based on a measure of earnings per share ("EPS"), meaning they were tied to financial results of which shareholders were the primary beneficiary.⁵⁸ Because the plans are focused more on shareholder-driven goals, the AG recommended that the costs be shared equally between shareholders and ratepayers, with the shareholder portion being removed for ratemaking purposes.⁵⁹

Atmos-Ky. opposed the AG's adjustment, stating that it was not unique in making incentive compensation part of the overall compensation package offered to employees, and that its total compensation package is designed to be in the middle of the job market in which it competes for talent.⁶⁰ Atmos-Ky. claimed that its incentive pay

⁵⁶ Responses to AG-1, Items 58, 60, and 61.

⁵⁷ Ostrander Corrected Testimony at 43.

⁵⁸ *Id.* at 45.

⁵⁹ In his post-hearing brief the AG urged that we disallow any incentive compensation.

⁶⁰ Densman Rebuttal at 13.

criteria provide benefits to customers because, in order for the criteria to be met, all of its employees must work together to ensure that it operates efficiently and effectively, which translates into lower costs and lower rates for customers.⁶¹

The Commission is in general agreement with the AG on this matter. Incentive criteria based on a measure of EPS, with no measure of improvement in areas such as safety, service quality, call-center response, or other customer-focused criteria, are clearly shareholder-oriented. As noted in the hearing on this matter, the Commission has long held that ratepayers receive little, if any, benefit from these types of incentive plans.⁶² Regarding Atmos-Ky.'s contention that customers benefit because its plans incentivize employees to work together to achieve efficiency and effectiveness, which translates into lower costs and lower rates, it is worth noting that Atmos-Ky.'s witness on this issue stated his belief that employees would strive to do what is right and do a "good job" without these additional incentives.⁶³ It has been the Commission's practice to disallow recovery of the cost of employee incentive plans that are tied to EPS or other earnings measures and we find Atmos-Ky.'s argument to the contrary unpersuasive. Accordingly, we will remove the full amount, \$1,164,455, from test-period operating expenses for ratemaking purposes.

Customer Service System ("CSS") Costs

In 2013, Atmos implemented a new CSS to replace a legacy system that had been in service since the mid-1990s. The total cost of the new CSS is approximately

⁶¹ *Id.* at 14.

⁶² Cross-examination of Joshua C. Densman, Jan. 23, 2014 Hearing at 16:24:54 – 16:28:09.

⁶³ *Id.* at 16:19:10 – 16:20:29.

\$78.9 million, of which \$4.5 million is allocated to Atmos-Ky.⁶⁴ The initial estimated cost of the system was \$64 million, based on a planned two-phase implementation. Upon determining that a single-phase implementation was more favorable, Atmos revised its estimate to \$72 million. Ultimately, the system's final installed cost was \$78.9 million, with the additional \$6.9 million largely due to the addition of internal resources needed to test the system prior to its implementation.⁶⁵

The AG proposed an adjustment to reduce test-year expenses by \$97,599 to recognize imputed cost savings related to implementing the new CSS.⁶⁶ The AG based the adjustment on estimated efficiencies and cost savings provided at Atmos Board of Director meetings, the increase in the cost of the CSS, and his belief that "Atmos must have anticipated certain quantitative and qualitative benefits related to implementation under the single stage approach (versus the 2-stage approach) and that these benefits should be shared with ratepayers. . . ."⁶⁷ The AG also proposed to reduce rate base by \$426,751 to eliminate one-half of the increase in the CSS's capital cost.

Atmos-Ky. contested the AG's proposals, stating that Atmos's internal projections of potential savings made nearly four years ago should not be binding.⁶⁸ It claimed that the AG was incorrect in his assumption that the capital cost over and above the initial

⁶⁴ Response to AG-2, Item 36.a.

⁶⁵ Response to AG-1, Item 97.

⁶⁶ Ostrander Corrected Testimony at 49.

⁶⁷ *Id.* at 50.

⁶⁸ Atmos-Ky.'s post-hearing brief at 36.

project estimate should generate a higher level of operational efficiencies.⁶⁹ Atmos-Ky. asserted that there were two primary drivers of the increase above the original estimate of capital investment: (1) changing the implementation approach from two-phase to single-phase; and (2) the increase in internal resources above those originally estimated for testing of the system prior to its “going live.”⁷⁰ It stated that the decision to alter the implementation approach and invest more in testing the system was made to ensure that the implementation was successful and seamless for customers and was not made to increase the scope of the system or add functionality to it.⁷¹

The Commission agrees with Atmos-Ky. that nearly four-year-old internal savings projections of the new CCS should not be binding in this situation. We find Atmos-Ky.’s explanation of the changes to the CCS project (ensuring that the implementation was successful and seamless for customers), which caused the final capital cost to exceed the initial estimate, to be reasonable. Likewise, we also find that there is inadequate support for the assumptions on which the AG’s proposed adjustments are based. Therefore, the Commission will not adopt the AG’s proposed expense and rate-base adjustments related to the implementation of the new CSS.

PRO FORMA ADJUSTMENTS SUMMARY

The effect of the Commission’s accepted adjustments on Atmos-Ky.’s pro forma test-period operations is as follows:

⁶⁹ Rebuttal Testimony of Gregory K. Waller at 2.

⁷⁰ *Id.*

⁷¹ *Id.*

	Atmos-Ky. Forecasted <u>Test Period</u>	Commission Accepted <u>Adjustments</u>	Commission Adjusted <u>Test Period</u>
Operating Revenues	\$155,374,969	\$ -0-	\$ 155,374,969
Operating Expenses	<u>141,914,891</u>	<u>(863,444)</u>	<u>141,914,447</u>
Net Operating Income	<u>\$ 13,460,078</u>	<u>\$ 863,444</u>	<u>\$ 14,323,522</u>

RATE OF RETURN

Cost of Debt

Atmos-Ky. proposed a cost of long-term debt for the test period of 6.19 percent, based on the forecast of total long-term debt expected to be in place on November 30, 2014.⁷² Because Atmos-Ky. proposed to exclude short-term debt from its capital structure, it likewise did not propose to include the cost of short-term debt. Information provided in Atmos-Ky.'s application was sufficient to show that the average short-term debt for the test period is 1.25 percent.⁷³

The Commission finds that the cost of long-term debt should be 6.19 percent. Consistent with its finding that short-term debt should be included in Atmos-Ky.'s capital structure, it further finds that the 1.25 percent average cost of short-term debt set out in the application should be used in calculating Atmos-Ky.'s rate of return.

Return on Equity

Atmos-Ky. recommends an ROE ranging from 10 percent to 11.3 percent, and specifically requests in its application an ROE of 10.7 percent based on its discounted cash flow model ("DCF"), the ex ante risk premium method, the ex post risk premium

⁷² Application, Schedule J-3.

⁷³ Application, Schedule J-2.

method, and Capital Asset Pricing Model (“CAPM”).⁷⁴ In its response to Item 48 of Staff’s Second Request, Atmos-Ky. recommended an updated ROE of 10.6 percent.

To perform the analysis in support of Atmos-Ky.’s recommendation, Dr. James H. Vander Weide employed two comparable risk proxy groups. The first group consists of nine natural gas companies. Each company is in the natural gas distribution business; paid quarterly dividends over the last two years; had not decreased dividends over the last two years; had an available I/B/E/S long-term earnings growth estimate;⁷⁵ and was not involved in an ongoing merger. Each also has an investment grade bond rating and a *Value Line Investment Survey* (“*Value Line*”) Safety Rank of 1, 2 or 3.⁷⁶ The second proxy group consists of seven water companies included in *Value Line Standard and Plus Editions* that: pay dividends; did not decrease dividends during any quarter for the past two years; have an I/B/E/S long-term growth forecast; and are not part of an ongoing merger.⁷⁷ Dr. Vander Weide stated that water utilities are included as a proxy group because the sample size of natural gas utilities is relatively small; water utilities are a reasonable proxy for investing in natural gas utilities in terms of risk; natural gas

⁷⁴ Direct Testimony of James H. Vander Weide at 3-4.

⁷⁵ *Id.* at 25. I/B/E/S, a division of Thomson Reuters, reports analysts’ EPS growth forecasts for a broad group of companies. The I/B/E/S growth rates are widely circulated in the financial community, include the projections of reputable financial analysts who develop estimates of future EPS growth, are reported on a timely basis to investors, and are widely used by institutional and other investors.

⁷⁶ *Id.* at 25.

⁷⁷ *Id.* at 28.

utilities are frequently used as proxies for water utilities in water cases;⁷⁸ and that the cost-of-equity results for a group of similar-risk companies is useful to examine as a test for the reasonableness of the cost-of-equity results for natural gas utilities.

Dr. Vander Weide applied a quarterly DCF model to the gas and water proxy groups. His DCF study uses analysts' estimates of forecasted EPS growth reported by I/B/E/S and *Value Line* to compute the growth rate expected by investors. The initial DCF analysis filed in Exhibit JW-1, Schedule I of the application sets out a "market-weighted average" for the gas proxy group utilities of 10 percent, including flotation cost. In response to a Staff information request, Atmos-Ky. stated that the simple average of the DCF analysis for the original proxy group, including flotation cost, is 9.7 percent; the market-weighted average, excluding flotation cost, is 9.7 percent; and that the simple average DCF ROE is 9.5 percent if flotation costs are excluded.⁷⁹ On November 15, 2013, Atmos-Ky. provided an update to its DCF analysis which showed a market-weighted average ROE of 9.9 percent, including flotation cost, for the eight gas proxy group utilities remaining after New Jersey Resources was excluded based on its DCF result's being so low that it failed Dr. Vander Weide's outlier test.⁸⁰ Model results for the individual companies are sufficient to show that the DCF analysis produces a simple

⁷⁸ In the final Orders in Case Nos. 2010-00036, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Dec. 14, 2010) and 2012-00520, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Oct. 25, 2013) the Commission found the use of natural gas utilities as proxies for water utilities to be inappropriate.

⁷⁹ Response to Staff's Second Request, Item 44.

⁸⁰ Atmos-Ky. Responses to Hearing Discovery Request, Question 1-10.

average ROE of 9.56 percent, including flotation cost, as updated by Atmos-Ky. on November 15, 2013, after the exclusion of New Jersey Resources' DCF result.⁸¹

For the water utility group, the DCF analysis produced a simple average ROE of 10.6 percent, with flotation costs, and a market-weighted average ROE of 11 percent. Atmos-Ky.'s response to Item 44 of Staff's Second Request indicated that, without flotation costs, the DCF results produced a simple average ROE of 10.4 percent and a market-weighted average ROE of 10.8 percent. Atmos-Ky.'s November 15, 2013 update showed a simple average DCF of 9.9 percent, with flotation costs, for the water group, and a market-weighted average ROE of 10.8 percent, including flotation costs.

Dr. Vander Weide relied upon data of gas distribution utilities for the ex ante risk premium ROE estimation and used a forecasted yield to maturity ("YTM") on A-rated utility bonds. The cost of equity produced by the ex ante risk premium is 11.3 percent, using a forecasted 6.55 percent forecasted YTM on A-rated utility bonds. For the ex post risk premium ROE estimation, Dr. Vander Weide relied upon stock price and dividend data from Standard & Poor's ("S&P") 500 stock portfolio and from Moody's A-rated Utility Bonds bond yield data. Using this method, the expected ROE is 10.4 to 10.9 percent with a mid-point of 10.6 percent, to which Dr. Vander Weide added an allowance for flotation cost to achieve an ROE of 10.8 percent. This calculation also included a forecasted YTM on A-rated utility bonds of 6.55 percent. In response to Item 47 of Staff's Second Request, Dr. Vander Weide confirmed that the Moody's average A-rated utility bond yield as of February 2013 was 4.18 percent. Using the 4.18 percent

⁸¹ New Jersey Resources' DCF Model Result as shown in Exhibit JWV-1, Schedule 1, of the application is 8.3 percent.

YTM as opposed to the forecasted 6.55 percent YTM produced ROEs of 10.3 percent for the ex ante risk premium and 8.5 percent for the ex post risk premium. Dr. Vander Weide stated in his response to Item 47 that the use of the 4.18 percent bond yield produces an unreasonably low cost-of-equity estimate, and noted that as of August 14, 2013, the average utility bond yield had risen to approximately 4.9 percent. When Atmos-Ky. provided updated information to Staff's Second Request on November 15, 2013, the ROE produced by the ex ante risk premium remained unchanged at 11.3 percent, and the ROE produced by the ex post risk premium had risen to 10.9 percent, including flotation cost and using the forecasted 6.55 percent YTM.

Dr. Vander Weide performed both historical and DCF-based CAPM analyses, producing ROEs of 10.2 and 10.6 percent, respectively, using forecasts of long-term Treasury bond yields; market-weighted average betas; and including flotation cost. Atmos-Ky.'s November 15, 2013 update included CAPM analyses with more current data. The historical CAPM ROE from that updated information was 10.34 percent, while the updated DCF-based CAPM ROE was 10.8 percent, both using an updated market-weighted average beta of .74. That update included a calculation showing that the simple average beta was .69 percent. For comparison purposes, the Commission notes that substituting the simple average beta of .69 for the market-weighted average beta results in ROEs of 10.01 percent and 10.18 percent, respectively, including flotation cost, for the historical and DCF-based CAPM analyses. Dr. Vander Weide concludes in his direct testimony that the cost-of-equity model results derived from CAPM should be given less weight for purpose of estimating the cost of equity because it underestimates the cost of equity for companies with betas significantly less than 1.0.

In its post-hearing brief, Atmos-Ky. discussed the introduction of a Regulatory Research Associates (“RRA”) report at the hearing which described average allowed ROE of all electric and gas utilities rate cases for 2013. It expressed concern regarding any “over reliance on a simple average return”; stated that the introduction of the report at the hearing implied that the average allowed return on equity could serve as a guide to the Commission; and enumerated the attendant problems if that were the case. Atmos-Ky. discussed in its brief the information it provided in response to Commission and Staff requests during the hearing, citing ROEs of Atmos’s distribution companies on average, Atmos-Ky.’s current PRP program ROE resulting from the settlement of its last rate case, and Atmos Mississippi’s ROE, all of which are currently over 10 percent.⁸²

The AG’s post-hearing brief referenced the ROE included in a recent settlement of an Atmos rate proceeding in Colorado, comparing the 9.72 percent ROE from that case to the 9.83 percent average ROE for gas utilities for the fourth quarter of 2013 and to the overall 2013 average ROE for gas utilities of 9.68 percent, as reported in the RRA report introduced at the hearing.⁸³ The AG concluded in his brief that, based on the national average allowed ROEs for gas utilities in 2013, an ROE of 9.68 percent, will provide more than a sufficient return to attract capital investment.

Having considered and weighed all the evidence in the record concerning the appropriate ROE for Atmos-Ky., the Commission finds a range of 9.3 percent to 10.3 percent to be reasonable. Within this range, an ROE of 9.8 percent will best allow Atmos-Ky. to attract capital at a reasonable cost, maintain its financial integrity to

⁸² Atmos-Ky.’s post-hearing brief at 43-44.

⁸³ AG’s post-hearing brief at 27.

ensure continued service, provide for necessary expansion to meet future requirements, and result in the lowest possible cost to ratepayers. In reaching our finding, we have excluded adjustments for flotation cost and have placed greater emphasis on the DCF and the CAPM model results of the gas utility proxy group. While recognizing that historical data has some value for use in obtaining estimates, we have given considerable weight to analysts' projections regarding future growth in the application of the DCF model. Finally, in assessing market expectations, we have recognized the importance of present economic conditions.

With regard to Atmos-Ky.'s concern about the aforementioned RRA report, this Commission does not rely on returns awarded in other states in determining the appropriate ROE for Kentucky jurisdictional utilities. It is reasonable to expect that other commissions, each with its own attributes, are evaluating expert witness testimony which uses the same or similar cost-of-equity models and an array of proxy groups, and reaching conclusions based on the data provided in the records of individual cases. The conclusions reached by those commissions, as well as this Commission, as to reasonable ROEs for a constantly changing group of utilities during different time periods are summarized periodically by RRA with explanatory reference points and are available to investors. To the extent that investors' expectations are influenced by such information, we believe that our 9.8 ROE will not appear unreasonable.

Rate of Return Summary

Applying Atmos-Ky.'s rates of 6.19 percent for long-term debt, 1.25 percent for short-term debt, and 9.8 percent for common equity to the approved capital structure

produces an overall cost of capital of 7.71 percent. The Commission finds this overall cost of capital to be fair, just, and reasonable.

REVENUE REQUIREMENTS

Based upon Atmos-Ky.'s rate base of \$252,737,721 and an overall cost of capital of 7.71 percent, the net operating income that could be justified for Atmos-Ky. is \$19,486,482. Recognizing the adjustments found reasonable herein, Atmos-Ky.'s pro forma net operating income for the test year is \$14,323,522. Based on the difference in these two amounts, Atmos-Ky. would need additional annual operating income of \$5,189,538. After recognizing the provision for uncollectible accounts, state and federal income taxes, and the PSC Assessment, Atmos-Ky.'s revenue deficiency would be \$8,550,134. The calculation of the revenue deficiency is as shown below:

Net Operating Income Deficiency	\$5,189,538
Divide By Gross Up Revenue Factor	<u>0.606954</u>
Overall Revenue Deficiency	<u>\$8,550,134</u>

PRICING AND TARIFF ISSUES

Cost-of-Service Study

Atmos-Ky. presented a fully allocated class cost-of-service study ("COSS") for the purpose of distributing revenue requirements among rate classes and determining rates of return on rate base at present and proposed rates for the following rate classes: Residential, Commercial and Public Authority, Firm Industrial, and Interruptible and Transportation. Atmos-Ky. revised the COSS in response to Staff's Third Information Request ("Staff's Third Request") and again when it filed its rebuttal testimony.⁸⁴

⁸⁴ Rebuttal Testimony of Paul H. Raab ("Raab Rebuttal"), Exhibit PHR-3.

Atmos-Ky.'s revised COSS indicated that, at present rates, class rates of return on rate base are: 1.5627 percent for Residential, 10.1022 percent for Commercial and Public Authority, .6805 percent for Firm Industrial, and 26.3634 percent for Interruptible and Transportation.⁸⁵ The total company rate of return is 5.3220 percent.⁸⁶ The rates of return at Atmos-Ky.'s proposed rates would be: 4.3323 percent for Residential, 15.0922 percent for Commercial and Public Authority, 4.3633 percent for Firm Industrial, and 29.6414 percent for Interruptible and Transportation.⁸⁷ Total company rate of return on rate base would be 8.5299 percent.⁸⁸ At proposed rates, Atmos-Ky.'s COSS shows that its proposed revenue allocation results in the class rates of return moving closer to an equalized rate of return.

Atmos-Ky. filed a Customer/Demand COSS utilizing a combination of peak day demands and customer number in allocating the cost of distribution mains. Atmos-Ky. used design day demand, stating that it was the most appropriate allocation method since its "transmission plant is built to meet the highest simultaneous peak established by customers."⁸⁹ Using a zero-intercept method in developing its classification factor for distribution mains, Atmos-Ky. classified them as approximately 85 percent customer-

⁸⁵ *Id.* at p. 1. The COSS filed with the application shows only the Residential class providing less than the system average return at present rates. The revised COSS filed as Exhibit PHR-3 shows both the Residential and Firm Industrial classes providing less than the system average return at present rates.

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ Direct Testimony of Paul H. Raab at 9.

related and 15 percent demand-related.⁹⁰ Atmos-Ky. states that this classification is consistent with classifications it proposed and the Commission accepted in its previous rate proceedings. It also states that the Commission approved a similar zero-intercept COSS used by Delta Natural Gas Company (“Delta”) in Case No. 2010-00116.⁹¹

The AG submitted an alternate Peak and Average COSS in the testimony of witness Glen Watkins.⁹² Although certain minor differences exist between the two COSSes, Atmos-Ky. and the AG agree that the primary difference lies in the treatment of distribution mains. The AG’s COSS allocates distribution mains based on both peak day and annual throughput. The AG states that the Peak and Average method is the most equitable method for assigning the costs of natural gas distribution mains because it recognizes utilization of the facilities throughout the year, but also recognizes that some classes rely on the facilities more than others during peak periods. The AG argues that in Atmos-Ky.’s COSS, 87 percent of the costs of service are allocated based on the number of customers regardless of their utilization of the system and that this places an unfair burden on residential customers.⁹³

On Rebuttal, Atmos-Ky. states that its COSS recognizes that some classes rely upon the facilities more than others during peak periods because it allocates a portion of distribution mains on the basis of customer class peak demand. Atmos-Ky. contends that “each class’s utilization of the Company’s facilities throughout the year” has no

⁹⁰ *Id.* at 12.

⁹¹ Case No. 2010-00116, *Application of Delta Natural Gas Company, Inc. for an Adjustment of Rates* (Ky. PSC Oct. 21, 2010).

⁹² A Peak and Average COSS is sometimes referred to as a Demand/Commodity COSS.

⁹³ AG’s post-hearing brief at 25.

bearing on the cost being allocated. It argues that it uses a network model to plan its system which considers only the number of customers to be served and their peak demands.⁹⁴ Finally, Atmos-Ky. makes reference to page 28 of the National Association of Regulatory Utility Commissioners Manual on Gas Rate Design dated August 6, 1981, and states that the only commodity-related costs identified are those related to the acquisition of natural gas, consistent with its COSS results. Atmos-Ky. concedes that “. . . there is no ‘absolute’ cost of service analysis that can be relied on by the Commission in all cases to guide the allocation of costs, and that whatever cost allocation methodologies are chosen should be used as a ‘guide’ rather than as an absolute prescription for rate design.”⁹⁵ Atmos-Ky. states, however, that when making a determination on which set of results to use as a guide in rate design, the Commission should consider whether the COSS sponsor has a particular constituency for which it is advocating. Atmos-Ky. contends that, when choosing allocators, Mr. Watkins chose those that would benefit the residential class.⁹⁶ Atmos-Ky. argues that it must take a broader view of what is fair and reasonable when making allocation decisions.

Based upon its review of Atmos-Ky.’s and the AG’s COSS, the Commission finds that a Peak and Average COSS such as the AG proposed reflects a reasonable methodology. However, we also find the methodology used by Atmos-Ky. to be reasonable and, with a greater amount of detail included so that the functionalization

⁹⁴ Raab Rebuttal at 14.

⁹⁵ *Id.* at 4.

⁹⁶ *Id.* at 7.

and classification in its COSS could be seen, represents an acceptable starting point in determining rate design in this proceeding.

Other COSS-Related Issues

Atmos-Ky. acknowledged that there is support for the approach used by the AG in previously filed COSSes in other jurisdictions.⁹⁷ In addition, Atmos-Ky. stated that “[b]oth approaches utilize traditional and accepted classification and allocation methods and yet produce widely divergent results of the ‘cost of service.’” It was for this reason that, in Case No. 10201,⁹⁸ the Commission encouraged Columbia to submit multiple-methodology COSSes in its future rate proceedings. The Commission reaffirmed this position in Case No. 90-013⁹⁹ when it encouraged Atmos-Ky.’s predecessor, Western, as well as other utility companies and intervenors, to file well-documented alternative and multiple-methodology COSSes to provide additional information for rate design. We continue to believe that such an approach to COSSes is appropriate and beneficial. Hence, the Commission strongly encourages Atmos-Ky. to file multiple-methodology COSSes in future rate cases in order to give the Commission a range of reasonable results for use in determining revenue allocation and rate design.¹⁰⁰

⁹⁷ *Id.* at 5.

⁹⁸ Case No. 10201, *An Adjustment of Rates of Columbia Gas of Kentucky, Inc.* (Ky. PSC Oct. 21, 1988).

⁹⁹ Case No. 90-013, *Rate Adjustment of Western Kentucky Gas Company* (Ky. PSC Sept 13, 1990) at page 50.

¹⁰⁰ In considering methodologies, Atmos is reminded the Commission voiced its concerns in the past with “methodologies that place all the emphasis on maximum design day as a way to allocate costs. This method may result in an inappropriate shift of costs to the residential customer class. For this reason, cost-of-service methodologies should give some consideration to volume of use.” Administrative Case No. 297, *An Investigation of the Impact of Federal Policy on Natural Gas to Kentucky Consumers and Suppliers* (“Admin. 297”) (Ky. PSC May 29, 1987), Order at 47.

The Commission notes that the AG's COSS in this proceeding failed to show the steps of functionalization and classification. When asked in an information request to provide the COSS electronically with all three steps shown separately, the AG provided an electronic copy that shows only the allocation step. When asked during the formal hearing to provide the COSS showing the omitted steps, Mr. Watkins stated that he had not performed the first two steps, and would not be able to provide it unless he was compensated.¹⁰¹ As was stated in Admin. 297, the Commission prefers that COSS be disaggregated to the greatest extent possible¹⁰² so that the functionalization and classification, as well as allocation, are available for review. Absent an analysis showing all steps of the COSS, the Commission is unable to fully analyze the COSS and therefore is unable to give it the same consideration as a study that includes an analysis of all three steps. With this Order, the Commission puts all parties to future rate proceedings on notice that we cannot give full consideration to a COSS that does not show separately each of the typical individual COSS steps of functionalization, classification, and allocation.

Revenue Allocation

According to Atmos-Ky., while the results of its COSS show that all customer classes except the residential class contribute adequately to its cost of service, it chose to allocate a portion of the requested revenue increase to each customer class.¹⁰³ It

¹⁰¹ January 23, 2014 hearing at 19:32:25.

¹⁰² Admin. 297 (Ky. PSC May 29, 1987), Order at at 42-43.

¹⁰³ As stated previously, the revised COSS filed as Exhibit PHR-3 shows both the Residential and Firm Industrial classes providing less than the system average return at present rates.

proposed to increase the customer charges and volumetric rates of all classes with the exception of special contract customers, and to allocate greater increases to volumetric charges as opposed to fixed monthly customer charges.¹⁰⁴ Atmos-Ky.'s proposed allocation of its requested base-rate increase results in maintaining approximately the same percentage of total revenue responsibility among customer classes as exists at current rates.¹⁰⁵

The AG recommended base-rate revenue increases for all customer classes as well, with lesser increases allocated to firm-sales customers, and with greater increases allocated to firm-transportation, and interruptible-sales and transportation customers. The AG recommended that revenue increases allocated to firm-sales customers be recovered via increases in volumetric rates only, with no increase in monthly customer charges for firm-G-1-sales customers.¹⁰⁶

The AG also recommended imputing an approximately \$3 million increase in base-rate revenues to special-contract customers or to Atmos shareholders.¹⁰⁷ The AG asserted that 50 percent of the tariff rate discounts attributable to 17 special contracts with 16 industrial customers subject to bypass threat should be borne by either those customers or shareholders, with the other 50 percent borne by other customers.¹⁰⁸ The AG stated in his post-hearing brief that it is possible some special contract customers

¹⁰⁴ Martin Testimony at 24.

¹⁰⁵ January 23, 2014 hearing at 11:58:06.

¹⁰⁶ Direct Testimony of Glenn A. Watkins at 44-45.

¹⁰⁷ *Id.* at 45.

¹⁰⁸ AG's post-hearing brief at 11-12.

are legitimate bypass threats, but that “it is likely that some of these contracts are unreasonable and some of the special contract customers are not legitimate threats to bypass Atmos.”¹⁰⁹ The AG also recommended that the Commission require Atmos-Ky. to provide an analysis of the reasonableness of the special contracts and whether they represent legitimate bypass threats. A similar analysis was a provision in the settlement agreement between the AG and Columbia Gas of Kentucky, Inc. (“Columbia”) in Case No. 2013-00167¹¹⁰ after the AG raised the same concern regarding the continued reasonableness of special contracts in that case. In the Commission’s final Order approving the settlement agreement, we ordered Columbia to submit the results of its analyses on the threat of bypass by its special contract customers as part of its next application for an adjustment of its base rates.

Responding to the AG’s proposal to impute \$3 million of special-contract revenue discounts to special-contract customers or Atmos shareholders, Atmos-Ky. asserted in its post-hearing brief that all its special contracts were filed with the Commission; were supported by financial analysis demonstrating that they generated revenue sufficient to cover all variable costs and make a contribution to fixed costs; were reviewed, accepted and stamped by the Commission; and that the revenues generated were included in each subsequent rate case before the Commission. Atmos-Ky. claimed that physical bypass of its system remains a viable option for each special-contract customer, and

¹⁰⁹ *Id.* at 12.

¹¹⁰ Case No. 2013-00167, *Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates for Gas Service* (Ky. PSC Dec. 13, 2013).

that it would be unwarranted and unjust to disallow the revenue discounts from its previously approved contracts.¹¹¹

The Commission agrees with both Atmos-Ky. and the AG that increases should be allocated to all sales and transportation rate classes. We do not agree, however, that it is reasonable to impute a rate increase to special-contract customers. With regard to the AG's proposal to impute \$3 million in revenue responsibility to special-contract customers, or to Atmos shareholders if Atmos-Ky. is not able to raise the rates of those customers, the Commission finds that there is no basis in the record of this proceeding to do so. Atmos-Ky. established to the Commission's satisfaction at the time of filing the special contracts that they generated revenue sufficient to cover the variable costs related to serving each customer and make contributions to fixed costs. However, the Commission also finds reasonable the AG's recommendation to require Atmos-Ky. to file analyses similar to that required of Columbia in its next base-rate application. The Commission will therefore require Atmos-Ky. to internally conduct and maintain studies, analyses, reports, quantifications, etc., that demonstrate the threat of bypass by each of its special-contract customers, and that the special contracts continue to generate sufficient revenue to cover variable costs and contribute to fixed costs. This information is to be provided in Atmos-Ky.'s next base-rate case application.

The Commission's revenue allocation as reflected in the rates found reasonable herein generally preserves the existing base-rate revenue responsibility among the classes, excluding gas cost.

¹¹¹ Atmos-Ky.'s post-hearing brief at 47-48.

Rate Design

Atmos-Ky. proposed no change in rate design, maintaining its current monthly base customer charge and declining block volumetric rates for all rate schedules. It proposed to increase the G-1 Firm Sales Service base customer charge to \$16.00 for residential customers and to \$40.00 for non-residential customers. It also proposed to increase the base customer charge for G-2 Interruptible Sales Service and for T-4 and T-3 Firm and Interruptible Transportation Service customers to \$350.00, which is supported by its COSS. Atmos-Ky. proposed to increase volumetric rates for all customer classes, with a greater relative increase allocated to the first block (0 – 300 Mcf) for G-1 firm sales customers and T-4 firm transportation customers.

As mentioned in the discussion on revenue allocation, the AG recommends that Atmos-Ky.'s residential base monthly customer charge not be increased above \$14.28, the residential base customer charge, including the Pipe Replacement Program ("PRP") surcharge, in effect when Atmos-Ky. filed its application. The AG stated that any increase awarded to Atmos-Ky. should be allocated to the volumetric delivery charge to give customers the opportunity to lower their bills through conservation.¹¹² The Commission notes that, based on the \$2.61 monthly residential PRP rate we approved effective October 1, 2013 in Case No. 2013-00304,¹¹³ Atmos-Ky.'s residential customers are now paying \$15.11 through the combination of the current \$12.50 base customer charge and PRP surcharge.

¹¹² AG's Post-Hearing Brief at 26.

¹¹³ Case No. 2013-00304, *Application of Atmos Energy Corporation to Establish PRP Rider Rates for the 12-Month Period Beginning October 1, 2013* (Ky. PSC Sept. 17, 2013).

The Commission finds Atmos-Ky.'s proposed monthly base customer charges, including the \$16.00 residential base customer charge, to be reasonable based on its COSS and the relatively minor increases from the level of monthly customer charges currently paid by all customer classes. Atmos-Ky.'s proposed rate design and customer charges for all customer classes should be approved, and the remainder of the revenue increase awarded herein should be recovered through higher volumetric rates. The volumetric rates approved herein are either identical to or approximate the volumetric rates proposed by Atmos-Ky. for the second and third rate blocks for G-1 firm sales and T-4 firm transportation rate classes; and for both blocks of G-2 interruptible sales and T-3 interruptible transportation customers. The remainder of the increase is recovered through the 0 – 300 Mcf block of firm sales and transportation customers, maintaining more closely the existing relationship between the first rate block and the second and third rate blocks than had been proposed by Atmos-Ky.

Weather Normalization Adjustment

Atmos-Ky. proposed that its Weather Normalization Adjustment (“WNA”) be granted permanent approval. Atmos-Ky. points out that Columbia, Delta, and Louisville Gas and Electric Company have all received permanent approval from the Commission of their WNA mechanisms. Atmos-Ky.'s proposed WNA tariff defines normal billing cycle HDD as being based on NOAA's 30-year normal for the period of 1981-2010. In Atmos-Ky.'s post-hearing brief, it alluded to testimony that it is willing to use a different data set for calculating its WNA, but stated its concern that the same data set should be used for normalizing test-year revenues in its rate case as is used for its WNA.

The Commission finds that Atmos-Ky.'s proposal for permanent approval of its WNA is reasonable and should be granted. Atmos-Ky.'s WNA tariff should likewise be approved including the language concerning NOAA's 30-year normal for the period ending 2010. In Atmos-Ky.'s future rate proceedings, this WNA tariff language setting out the time period used should be updated to reflect the time period approved by the Commission to weather normalize revenues in those rate proceedings.

Margin Loss Rider and System Development Rider

Atmos-Ky. proposed to implement two new tariffs, a Margin Loss Rider ("MLR") and a System Development Rider ("SDR"), which it believes will help delay the time and cost associated with a general rate case.¹¹⁴ Atmos-Ky. proposes the MLR to recover 50 percent of margins lost due to the Economic Development Rider ("EDR"), its Alternative Fuel Flex Provision, or negotiated rates with pipeline bypass candidates. It proposed the lost margin as half the difference between existing tariff rates and the negotiated special contract rates collected over estimated sales volumes of rate schedules G-1 and G-2 (firm and interruptible sales service rate schedules). The proposed MLR tariff contains a Balancing Adjustment provision to reconcile the difference between billed revenues and revenues that would have been billed absent the rider, plus interest at the average the 3-month Commercial Paper Rate for the immediately preceding 12-month period. In support of its proposal, Atmos-Ky. stated that the Commission approved an MLR tariff in a general rate proceeding of Atmos-Ky.'s predecessor company, Western,

¹¹⁴ Martin Testimony at 30.

in Case No. 1999-070.¹¹⁵ That tariff resulted from a unanimous settlement agreement and provided for lost revenues to be shared equally by ratepayers and shareholders.

The SDR is proposed to recover investment related to economic development initiatives for overall system or reliability improvement that cannot be directly assigned to a customer or group of customers. Atmos-Ky. states that the SDR is intended to encourage industrial development, infrastructure investment and job growth within its service area. Atmos-Ky.'s proposed tariff describes the SDR revenue requirement as consisting of the following:

1. SDR-related Plant In-Service not included in base gas rates minus the associated SDR-related accumulated depreciation and accumulated deferred income taxes;
2. Retirement and removal of plant related to SDR construction;
3. The rate of return on the net rate base being the overall rate of return on capital authorized for the Company's Pipe Replacement Program Rider;
4. Depreciation expense on the SDR related Plant In-Service less retirements and removals; and
5. Adjustment for ad valorem taxes.

Atmos-Ky. proposed that the SDR rate be charged to the G-1 and G-2 rate classes in proportion to their relative base revenue shares approved in its most recent rate case.

¹¹⁵ Case No. 1999-070, *The Application of Western Kentucky Gas Company for an Adjustment of Rates* (Ky. PSC Dec. 21, 1999).

The Commission, in Administrative Case No. 327 (“Admin. 327”),¹¹⁶ specifically stated that utilities with active EDR contracts should demonstrate through detailed cost-of-service analysis that nonparticipating ratepayers are not adversely affected by EDR customers, and that cost-recovery issues are to be held for general rate proceedings. Atmos-Ky. proposed these same riders in Case No. 2012-00066,¹¹⁷ in which it stated that EDR promotes an important public purpose similar to pipe-replacement programs and, therefore, it should be permitted to recover its costs on a more current basis.¹¹⁸ The Commission approved Atmos-Ky.’s EDR in Case No. 2012-00066, but did not approve the MLR and SDR riders. Atmos-Ky. states in its application in the instant proceeding that all customers will share in the benefits of increased industrial development and job creation and as a result should not be considered adversely affected by the proposed MLR and SDR riders. In spite of this claim, Atmos-Ky. stated in response to Item 177 of the AG’s First Request for Information and in response to Item 27 of Staff’s Third Request that transportation customers would not be expected to benefit as much from development, infrastructure investment, and job growth as G-1 and G-2 sales customers, which are the only customer classes proposed to be subject to the riders.

¹¹⁶ Administrative Case No. 327, *An Investigation into the Implementation of Economic Development Rates by Electric and Gas Utilities* (Ky. PSC Sept. 24, 1990).

¹¹⁷ Case No. 2012-00066, *Application of Atmos Energy Corporation for an Order Approving Economic Development Riders* (Ky. PSC Aug. 27, 2012).

¹¹⁸ The Commission acknowledged in the final Order in Case No. 2012-00066 that EDRs promote a public purpose, but stated that it was not persuaded that the purpose is similar to the issue of public safety that is promoted by the pipe replacement programs of Atmos and other gas utilities.

The AG recommended that the MLR not be approved, citing the fact that the MLR was previously approved in a black box settlement and not as a result of a litigated proceeding.¹¹⁹ The AG stated in his post-hearing brief that Atmos-Ky. should not be awarded an MLR that would encourage future special contracts, which he is concerned would not be responsibly administered. If the Commission approves an MLR for Atmos-Ky., the AG recommends that we impose conditions and exercise ongoing supervision over such a mechanism.¹²⁰ The AG had no recommendation with regard to the SDR.

The Commission finds that the record in this proceeding does not support Atmos-Ky.'s need for an MLR or an SDR. In response to hearing requests for information concerning the MLR, Atmos-Ky. stated that, since 2009, it had revenue losses of only \$3,543 due to fuel switching through its Alternative Fuel Flex Provision, no revenue losses from new special contracts, and that it has entered into no EDR contracts.¹²¹ The Commission notes that if Atmos-Ky. were to enter into a special contract with an EDR customer, in most instances it should be to add incremental load and that revenue collected from that customer would be in addition to base-rate revenues approved in this rate case. Because Atmos-Ky.'s experience over the last five years does not support the likelihood of revenue losses that would indicate the need for such a revenue-stabilizing mechanism, the Commission finds that the addition of the proposed MLR to Atmos-Ky.'s tariffs is not warranted or reasonable.

¹¹⁹ AG's post-hearing brief at 13.

¹²⁰ *Id.* at 14.

¹²¹ Atmos-Ky.'s Responses to Hearing Discovery Requests, Question 1-03.

Atmos-Ky.'s response to Item 5 of Staff's Third Request indicates no revenue loss in the last five years resulting from projects that would have qualified for recovery through the SDR if such a tariff rider had been in use during that time, and that no such projects are contemplated during the period 2014 through 2019. While we support economic development efforts that benefit jurisdictional utilities, their customers, their shareholders, and their service areas as evidenced by the findings in Admin. 327, the Commission finds that the SDR is not warranted or reasonable based on the record of this proceeding. The Commission further finds that its denial of the SDR should be without prejudice for Atmos-Ky. to request the SDR in the future if it experiences increasing opportunities for projects that would be subject to such a mechanism.

General Firm Sales (G-1) & Interruptible Sales (G-2) Natural Gas Vehicle Provisions

Atmos-Ky. proposed to add the same language to its G-1 and G-2 sales tariffs that is contained in its T-3 and T-4 Transportation Service tariffs to accommodate sales customers that would like to offer natural gas as a motor vehicle fuel. The additional language will permit sale of gas delivered to a customer for resale only if the gas is used as a motor vehicle fuel. Atmos-Ky.'s revision to its G-1 and G-2 sales tariffs to permit the sale of natural gas for resale as a motor vehicle fuel is reasonable, is in keeping with its transportation tariffs, and should be approved.

\$10 Door Tag Fee

Atmos-Ky. proposed to implement a \$10 Door Tag Fee to be charged after a customer's account becomes delinquent and it hangs a door tag at the customer's premises. Atmos-Ky. states that, at times, an employee will drive to the customer's premises and leave a door tag notifying the customer that gas service will be

disconnected if the bill is not paid.¹²² The purpose of the fee, according to Atmos-Ky., is to benefit customers by preventing disconnection and potentially eliminating more costly reconnection charges. This fee would be in addition to a \$39 reconnect fee a customer is required to pay to re-establish service if the customer is disconnected for non-payment.¹²³ Atmos-Ky. did not provide any cost justification for the fee, but claimed the fee was nominal and would only help to offset the cost of the employee trip.

In response to a Commission Staff request for information, Atmos stated that it “does not plan on using [the door tags] often, but wanted to reinstitute the option since it was a past practice.”¹²⁴ During testimony provided at the public hearing, however, Atmos-Ky. noted that it intended that the Door Tag Fee be implemented on a pilot basis, that its use will be discontinued if it proves to be unsuccessful,¹²⁵ and that the fee would be applied to all customers who received a disconnect notice.¹²⁶

The AG took no position on the proposed fee.

Due to the lack of cost support and somewhat inconsistent information provided, the Commission will deny Atmos-Ky.’s request to implement the \$10 door tag fee. The Commission is concerned by the fact that, while a customer could benefit by avoiding a more costly \$39 reconnect fee, a customer not heeding the door tag would be required to pay \$10 in addition to all other fees. Should Atmos-Ky. wish to propose a door tag

¹²² Martin Testimony at 31-32.

¹²³ January 23, 2014 hearing at 11:51:45.

¹²⁴ Response to Staff’s Second Request, Item 27.

¹²⁵ January 23, 2014 hearing at 11:52:55.

¹²⁶ *Id.* at 11:53:35.

fee in a future application, it should file more supporting details for the fee, including but not limited to the fee's success as a deterrent to non-payment and disconnection in other jurisdictions; cost support justifying the proposed charge; an estimate of revenue to be collected by the fee; and the details of the proposed pilot program if it is to be implemented as a pilot.

Other Tariff Changes

Atmos-Ky. proposed changes to its tariffs to reflect revisions to the Commission's regulations. Through the process of discovery, Atmos-Ky. agreed to further revise its tariffs, and provided amended tariff sheets incorporating all revisions. Atmos-Ky.'s tariff revisions as proposed and as further developed through the process of discovery are reasonable and should be approved.

Gas Transportation Thresholds

In 2010, the Kentucky General Assembly adopted Joint Resolution 141, which directed the Commission to commence a collaborative study of natural gas retail competition programs and to prepare and submit a report to the Kentucky General Assembly and the Legislative Research Commission. Pursuant to that directive, the Commission established Case No. 2010-00146 to conduct an investigation of natural gas competition.¹²⁷ After developing a record that consisted of discovery responses, testimony, and public comments, and conducting a public hearing, the Commission concluded that the existing transportation thresholds of jurisdictional local distribution

¹²⁷ Case No. 2010-00146, *An Investigation of Natural Gas Competition Programs* (Ky. PSC Dec. 28, 2010).

companies (“LDCs”) should be further examined, and that each LDC’s tariffs and rate design would be evaluated in its next general rate proceeding.

In its rate application in this proceeding, Atmos-Ky. discusses its transportation and pooling services and its 9,000 Mcf per year volumetric eligibility threshold. It stated its belief that its existing eligibility threshold is set at an appropriate level and proposed no changes to its transportation service. The issue of Atmos-Ky.’s transportation service and eligibility threshold was further developed through the process of discovery by Staff, and was addressed by Stand’s March 13, 2014 Brief and by Atmos-Ky.’s March 21, 2014 Reply Brief. Atmos-Ky. established through testimony and responses to discovery that it has approximately 30 customers that qualify for transportation service but choose to stay on sales service;¹²⁸ that over the last five years it has received only four requests for transportation service from non-residential customers whose volumetric usage would make them ineligible for transportation service;¹²⁹ that up-front costs such as electronic flow metering, monthly administration fees and potential cash out obligations would make it difficult for lower-volume-usage customers to achieve savings;¹³⁰ and that its existing transportation service threshold is not an outlier compared to other Kentucky jurisdictional LDCs.¹³¹

Stand recommends that Atmos-Ky.’s volumetric transportation threshold be lowered to allow more customers to purchase natural gas in the market. Stand states

¹²⁸ Martin Testimony at 33-34.

¹²⁹ Response to Staff’s Second Request, Item 11.

¹³⁰ Martin Testimony at 33.

¹³¹ Response to Staff’s Third Request, Item 6.

that the Commission should require Atmos-Ky. to lower the threshold from 9,000 to 3,000 Mcf per year if Atmos-Ky. will not do so voluntarily.¹³² According to Stand, its suggestion is based on general industry knowledge, the thresholds of other LDCs, and the record in this case and that of Case No. 2010-00146.¹³³ Stand states that utilities in Kentucky and other states have proven that any risks and dangers of gas transportation are resolved by properly drafted tariffs which are not unduly punitive, do not unduly benefit the utility, and which serve to control supplier behavior.¹³⁴ Stand also advises that if the transportation threshold is lowered, the Commission must guard against the risk that other provisions of Atmos-Ky.'s tariff would be made more punitive and restrictive.¹³⁵ Stand cites the following as reasons that Atmos-Ky. should be indifferent to whether it or another supplier is supplying gas to its customers: (1) Atmos-Ky. is not allowed to profit from providing sales gas; and (2) Atmos-Ky. charges fees to transportation customers to address system balancing issues. Stand states that these factors justify lowering the threshold to transport. Stand also contends that it is unclear why Atmos-Ky. or the Commission has not lowered the volumetric threshold to transport.¹³⁶ Stand referred to the record in 2010-00146 as containing evidence that every customer for whom it had provided information in response to Staff data requests

¹³² Stand's Brief at 6.

¹³³ *Id.*

¹³⁴ *Id. at 7.*

¹³⁵ *Id. at 8.*

¹³⁶ *Id.*

had saved money compared with what it would have been charged by its LDC.¹³⁷ It suggests that the fact that the 30 customers who qualify for transportation service choose to stay on sales service indicates a lack of information available to Atmos-Ky. customers regarding transportation tariff options and the relative costs and benefits of sales versus transportation service.¹³⁸

In response to Stand's argument regarding the issue of the volumetric eligibility threshold for transportation service, Atmos-Ky. states that Stand provided no evidence supporting its recommendation to reduce the threshold from 9,000 to 3,000 Mcf per year, and that it provided only broad generalization concerning the issue.¹³⁹ Atmos-Ky. argues, in response to Stand's uncertainty as to why the Commission has not lowered its volumetric threshold for transportation service, that the reason is the lack of demand from customers for a lower threshold and that the Commission has no basis to arbitrarily impose a reduction. Atmos-Ky. submits that it is a lack of interest and economic benefit that causes sales customers otherwise eligible for transportation service to remain sales customers, and not a lack of information, as Stand claims.¹⁴⁰ Atmos-Ky. states the Commission should not accept Stand's apparent assumption that customers are incapable of obtaining information and making informed judgments.¹⁴¹

¹³⁷ *Id.* at 9.

¹³⁸ *Id.* at 11.

¹³⁹ Atmos-Ky.'s reply brief at 4.

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

The information in the record in this case reflects a meaningful effort to address the Commission's directive in Case No. 2010-00146 that gas transportation thresholds be examined in each LDC's next rate case. We find that the exploration of Atmos-Ky.'s gas transportation services and issues surrounding the availability of such service to more customers satisfies the intent of our Order in that case. There is nothing in the record of this proceeding to indicate that sales customers are disadvantaged by Atmos-Ky.'s decision to maintain its existing 9,000 Mcf per year transportation threshold. In the almost 10 months that this rate case has been before the Commission, no customer filed comments in opposition to Atmos-Ky.'s existing 9,000 Mcf per year transportation threshold and no customer requested to intervene to challenge that threshold level. Atmos-Ky.'s volumetric threshold is not the lowest among Kentucky LDCs, nor is it the highest. The Commission will continue to monitor the issue of transportation thresholds in future base-rate proceedings, and Atmos-Ky. should anticipate further inquiry regarding sales customers' expressions of interest in transportation service.

OTHER ISSUES

Stand's Allegations

Stand alleged in its post-hearing brief that it has been denied due process in this matter on two grounds: 1) the Commission did not have the authority to limit the scope of Stand's intervention to the issue of Atmos-Ky.'s threshold for transportation service; and 2) Stand was denied the right to participate in discovery due to the timing of our Order granting intervention. We will address each of these allegations separately.

The Commission finds that the only person with a statutory right to intervene is the AG, pursuant to KRS 367.150(8)(b). Intervention by all others is permissive and is

within the sound discretion of the Commission. In the unreported case of *EnviroPower, LLC v. Public Service Commission of Kentucky*, No. 2005-CA-001792-MR, 2007 WL 289328 (Ky. App. Feb. 2, 2007), the Court of Appeals ruled that this Commission retains power in its discretion to grant or deny a motion for intervention, but that discretion is not unlimited. The Court enumerated the statutory and regulatory limits on Commission discretion in ruling on motions to intervene. The statutory limitation, KRS 278.040(2), requires that the person seeking intervention have an interest in the rates or service of a utility, as those are the only two subjects under the jurisdiction of the Commission.

The issues presented in *EnviroPower* are analogous to the instant case with regard to Commission discretion in granting intervention.¹⁴² Similar to *EnviroPower's* interest as a competitor in East Kentucky Power Company's ("EKPC") construction of a coal-fired generating plant, Stand's interest as a private natural gas marketer arguably places it in direct competition with Atmos-Ky. in its role as provider of the natural gas commodity to its sales customers. *EnviroPower* was neither a ratepayer of EKPC nor did it represent a ratepayer of EKPC. Stand is likewise not a ratepayer of Atmos-Ky. nor does it represent a ratepayer in this proceeding.

¹⁴² In *EnviroPower*, East Kentucky Power Cooperative Inc. ("EKPC") applied for a Certificate of Public Convenience and Necessity ("CPCN") to self-construct a 278-MW coal-fired generating plant at its Spurlock Station site in Maysville, Kentucky. Before making its application for a CPCN, EKPC had issued a "Request for Proposals" for various contractors to bid on supplying the necessary power. *EnviroPower* was one of 39 unsuccessful bidders. The Commission denied *EnviroPower's* request to intervene upon finding that it was not a ratepayer of EKPC, but a rejected bidder whose interests were not identical to ratepayers'; and that *EnviroPower* had a legal duty to its members to maximize profits; a far different goal from the protection of ratepayers. Although intervention was denied, *EnviroPower* was added to the service list so that it could monitor the proceedings, submit further information and comment upon the issues and in fact it filed extensive comments in the form of prepared testimony.

It is only because of an assurance made by the Commission in Case No. 2010-00146, *An Investigation of Natural Gas Retail Competition Programs*,¹⁴³ that Stand was granted intervenor status in this matter. The Commission, in its final report to the Kentucky General Assembly in Case No. 2010-00146, states, “The Commission believes that existing transportation thresholds bear further examination, and the Commission will evaluate each LDC’s tariffs and rate design in each LDC’s next general rate proceeding.”¹⁴⁴ As this is Atmos-Ky.’s first general rate proceeding following the Commission’s report, and consistent with the report, Stand was granted intervention in the current matter but its intervention was limited “to participation on the issues of Atmos Energy’s transportation threshold levels and any other matters related thereto, but not to whether a Pilot Program for Schools or enhanced Standards of Conduct should be added.” The Commission disagrees with Stand’s argument that it should have been allowed to explore these other topics in the present case. We find both topics to be extraneous to our consideration of either transportation thresholds, as we agreed to consider in our final report in Case No. 2010-00146, or to our consideration of Atmos-Ky.’s application for an adjustment of rates in the present case. Stand contends that an amendment to the Commission’s administrative regulations, which removed both the words “limited” and “full” pertaining to intervention, arguably grant Stand, as an intervenor in this case, the right to interject any topic it chooses into a proceeding before the Commission, regardless of either its relevance or applicability to the matter at hand.

¹⁴³ Case No. 2010-00146, *An Investigation of Natural Gas Retail Competition Programs* (Ky. PSC Dec. 28, 2010).

¹⁴⁴ *Id.* at 23.

We find this position to be erroneous. Neither the Commission's former regulation pertaining to intervention,¹⁴⁵ nor as it was amended in 2013,¹⁴⁶ bestow upon any intervenor the right to introduce tangential issues into Commission proceedings, as Stand has attempted to do in this matter regarding a pilot program for Kentucky's school facilities and regarding its promotion of Commission-imposed Standards of Conduct against Atmos-Ky. Further, the prior provision in our regulations allowing for "limited intervention" had nothing to do with limiting the issues that could be addressed by an intervenor. Rather, the limitation in "limited intervention" extended only to the documents that other parties had to serve on the limited intervenor and the exclusion of the limited intervenor as a designated party for purposes of rehearing or judicial review.

Stand maintains that it was denied due process because the Commission did not rule on its motion to intervene for more than three months and then after the closure of discovery. The Commission finds Stand's position without merit on two separate grounds. First, 807 KAR 5:001, Section 4(11)(d), the amended regulation regarding intervention which Stand earlier touts, states, "Unless the commission finds good cause to order otherwise, a person granted leave to intervene in a case shall, as a condition of his intervention, be subject to the procedural schedule in existence in that case when the order granting the person's intervention is issued." Although Stand would seem to imply otherwise, there is nothing in this provision that conditions its applicability on when intervention is granted by the Commission. In addition, there is nothing in the record to indicate any effort by Stand to seek amendment of the procedural schedule in place at

¹⁴⁵ 807 KAR 5:001, Section 3(8).

¹⁴⁶ 807 KAR 5:001, Section 4(11).

the time it was granted intervention. The initial language, "Unless the commission finds good cause to order otherwise. . ." would allow the Commission to amend the procedural schedule if "good cause" exists, but Stand never made such a request or brought its concern to the Commission while the evidentiary record was open. In fact, Stand never raised the claim of a denial to participate in discovery until it filed its post-hearing brief, which was over six months after it was granted intervention. Thus, its recent claim that it was denied due process is unconvincing.

The Commission also finds Stand's claim that it was denied the opportunity to participate in discovery disingenuous on a second level. At the time Stand was granted intervention on September 3, 2013, the only discovery deadline that had passed was the request for information to Atmos-Ky. due on August 14, 2013, to which Atmos-Ky. responded on August 28, 2013. After the Commission's September 3, 2013 Order granting its intervention, Stand had the opportunity to file supplemental requests for information to Atmos-Ky. by September 11, 2013; to file intervenor testimony by October 9, 2013; and to file requests for information to the AG by October 23, 2013. Stand had each of these opportunities as part of the original procedural schedule, which it accepted as a condition of its intervention,¹⁴⁷ and did not request be amended.

Stand's participation in this case has been minimal. Following the filing of its motion to intervene and memorandum in support of its motion, which primarily advocated that Atmos-Ky. be required to implement a pilot program for Kentucky School

¹⁴⁷ 807 KAR 5:001, Section 4(11)(d).

Facilities¹⁴⁸ and that the Commission impose Standards of Conduct against Kentucky gas utilities with unregulated gas marketing affiliates,¹⁴⁹ both issues that are outside the scope of these proceedings, its participation has consisted of briefly questioning two of Atmos-Ky.'s ten witnesses at the January 23, 2014 hearing, each for less than five minutes,¹⁵⁰ and filing a post-hearing brief.¹⁵¹

Stand did not request that the procedural schedule be amended; did not file supplemental requests for information to Atmos-Ky.; did not request information from the other intervenor; did not file testimony on its own behalf or present any witnesses at the January 23, 2014 hearing; did not question eight of Atmos-Ky.'s ten witnesses who testified at the January 23, 2014 hearing; and did not question either of the Attorney General's two witnesses who testified at the January 23, 2014 hearing.

In summary, we find that Stand's choices regarding its level of participation in this case create no substantive or procedural due process violations by the Commission.

Depreciation Study

Atmos-Ky.'s depreciation rate study filed as part of its application¹⁵² is the first depreciation rate study filed by Atmos-Ky. since its 2006 general rate case.¹⁵³ Based

¹⁴⁸ Memorandum Supporting Motion of Stand Energy Corporation to Intervene at pp.5-6.

¹⁴⁹ *Id.* at 7.

¹⁵⁰ Cross-Examination of Mark Martin at 11:17:35–11:20:00 and Cross-Examination of Gary Smith at 5:59:41–6:04:21, January 23, 2014 hearing.

¹⁵¹ By Order issued March 7, 2014, the Commission granted Stand's e-mail request for additional time to file a post hearing brief.

¹⁵² Direct Testimony of Dane A. Watson.

¹⁵³ Case No. 2006-00464, *Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC July 31, 2007).

on the current study's results, Atmos-Ky. proposed new depreciation rates that would increase its annual depreciation expense by approximately \$1.1 million.

The Commission finds that Atmos-Ky.'s proposed depreciation rates are reasonable and should be approved for use by Atmos-Ky. on and after the effective date of the gas service rates approved herein. The Commission also finds that Atmos-Ky. should prepare a new depreciation rate study for Commission review by the earlier of five years from the date of this Order or the filing of Atmos-Ky.'s next application for an adjustment in its base rates.

Wireless Meter Reading

Atmos-Ky.'s application indicated that in fiscal year 2014 it would undertake a Wireless Meter Reading ("WMR") project.¹⁵⁴ It intends to install 20,000 WMR devices in areas where (1) it currently uses contract meter readers, (2) it expects to experience workforce reductions due to retirements and relocations, and (3) meter reading is costly due to the time required for individual reads.¹⁵⁵ While Atmos-Ky. does not expect significant savings in the near term, it indicates that, over time, company meter readers would be trained for other positions that become vacant due to retirements and would fill those positions, resulting in an overall reduction in the required number of operational employees.¹⁵⁶

Although Atmos-Ky. did not reflect any decrease in expenses during the test year due to the WMR project, but expects to realize savings from the project in the long term.

¹⁵⁴ Direct Testimony of Ernest B. Napier at 13.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.* at 14.

The Commission is interested in the level of savings Atmos-Ky. will realize as a result of the WMR project on a long-term term basis. Accordingly, in conjunction with its next general rate application, we find that Atmos-Ky. should submit an analysis of the costs incurred and savings realized because of the WMR project from its inception to a date within 90 days of the submission of the rate application.

SUMMARY

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds that:

1. The rates set forth in the Appendix to this Order are the fair, just, and reasonable rates for Atmos-Ky. to charge for service rendered on and after January 24, 2014.

2. The rate of return granted herein is fair, just, and reasonable and will provide sufficient revenue for Atmos-Ky. to meet its financial obligations with a reasonable amount remaining for equity growth.

3. The rates proposed by Atmos-Ky. would produce revenue in excess of that found reasonable herein and should be denied.

4. Atmos-Ky.'s proposal to implement new depreciation rates based on the depreciation study it filed in this proceeding should be granted with the new depreciation rates to be effective as of the effective date of the gas service rates approved herein.

5. Atmos-Ky. should file a new depreciation study for Commission review by the earlier of five years from the date of this Order or the filing of its next general rate application.

6. The proposed MLR and SDR tariffs are not currently warranted and should be denied.

7. The proposed Door Tag Fee is not reasonable and should be denied.

8. Atmos-Ky.'s request for permanent approval of its WNA tariff and the proposed language concerning NOAA's 30-year normal for the period ending 2010, which should be updated with each base-rate proceeding, is reasonable and should be approved.

9. Atmos-Ky.'s proposal to revise its G-1 and G-2 sales tariffs to permit the resale of natural gas as a motor vehicle fuel is reasonable and should be approved

10. All other tariff modifications proposed by Atmos-Ky. or agreed to by Atmos-Ky. through the discovery process in this proceeding are reasonable and should be approved.

11. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit the IRS private-letter ruling required herein, and should defer the related cost in a regulatory asset account to be addressed in that rate proceeding.

12. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit the comparison required herein of weather-normalization methodologies along with support for the time period it proposes to use to normalize revenues, including the superiority of the chosen method in terms of its predictive value for future temperatures.

13. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit the results of its analyses required herein on the

threat of bypass posed by its special contract customers and on the sufficiency of the revenue generated by these customers to continue to cover variable cost and make a contribution to fixed cost.

14. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit an analysis of the costs incurred and savings realized due to the WMR project from its inception to a date within 90 days of the submission of the rate application.

15. As part of its next application for an adjustment of its base rates for gas service, Atmos-Ky. should submit multiple-methodology COSSES in order to give the Commission a range of reasonable results for use in determining rate design.

16. Future COSSES filed by any party should show separately each of the typical individual COSS steps of functionalization, classification, and allocation.

17. The record in this proceeding regarding Atmos-Ky.'s gas transportation services and issues surrounding the availability of such service satisfies the intent of our Order in Case No. 2010-00146.

IT IS THEREFORE ORDERED that:

1. The rates and charges proposed by Atmos-Ky. are denied.
2. The rates in the appendix to this Order are approved for service rendered by Atmos-Ky. on and after January 24, 2014.
3. The depreciation rates proposed by Atmos-Ky. are approved.
4. Atmos-Ky. shall submit a new depreciation study for Commission review by the earlier of five years from the date of this Order or the filing of its next general rate case.

5. Within 20 days of the date of this Order, Atmos-Ky. shall file with the Commission, using the Commission's Electronic Tariff Filing System, new tariff sheets setting forth the rates, charges, and revisions approved herein and reflecting their effective date and that they were authorized by this Order.

6. Within 60 days from the date of this Order, Atmos-Ky. shall refund with interest all amounts collected for service rendered from January 24, 2014, through the date of this Order that are in excess of the rates set out in the appendix to this Order. The amount refunded to each customer shall equal the amount paid by each customer during the refund period in excess of the rates approved herein.

7. Atmos-Ky. shall pay interest on the refunded amounts at the average of the 3-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release on the date of this Order.

8. Within 75 days from the date of this Order, Atmos-Ky. shall submit a written report to the Commission in which it describes its efforts to refund all monies collected in excess of the rates that are set forth in the appendix to this Order.

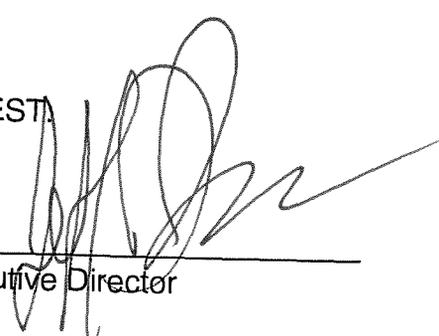
9. Any documents filed pursuant to ordering paragraph 8 of this Order shall reference the number of this case and shall be retained in the utility's post case reference file.

10. Atmos-Ky.'s next application for an increase in its base rates shall contain the information required in finding paragraphs 11 through 14.

By the Commission

ENTERED
APR 22 2014
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST



Executive Director

Case No. 2013-00148

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2013-00148 DATED **APR 22 2014**

The following rates and charges are prescribed for the customers served by Atmos Energy Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

RATE G-1
GENERAL FIRM SALES SERVICE

Base Charge

\$16.00 per meter per month for residential service
\$40.00 per meter per month for non-residential service

Distribution Charge

First	300 Mcf	\$ 1.3180 per Mcf
Next	14,700 Mcf	\$.8800 per Mcf
Over	15,000 Mcf	\$.6200 per Mcf

RATE G-2
INTERRUPTIBLE SALES SERVICE

Base Charge

\$350.00 per delivery point per month

Distribution Charge

First	15,000 Mcf	\$.7900 per Mcf
Over	15,000 Mcf	\$.5300 per Mcf

RATE T-3
INTERRUPTIBLE TRANSPORTATION SERVICE

Base Charge

\$350.00 per delivery point per month

Distribution Charge for Interruptible Service

First	15,000 Mcf	\$.7900 per Mcf
Over	15,000 Mcf	\$.5300 per Mcf

RATE T-4
FIRM TRANSPORTATION SERVICE

Base Charge

\$350.00 per delivery point per month

Distribution Charge for Firm Service

First	300 Mcf	\$ 1.3180 per Mcf
Next	14,700 Mcf	\$.8800 per Mcf
Over	15,000 Mcf	\$.6200 per Mcf

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